

July 2001 Version

Draft Check Truncation Act

SECTION 1. SHORT TITLE.

This Act may be cited as the "Check Truncation Act."

SECTION 2. DEFINITIONS.

(a) Account means a deposit account with a bank.

(b) Bank means-

- (1) Any person, located in a State, engaged in the business of banking;
- (2) A Federal Reserve Bank;
- (3) A Federal Home Loan Bank; and
- (4) To the extent it acts as a payor, the U.S. Treasury, the U.S. Postal Service, or a State or local government.

(c) Banking day has the meaning given to such term in section 229.2 of title 12, Code of Federal Regulations.

(d) Business day has the meaning given to such term in section 229.2 of title 12, Code of Federal Regulations.

(e) Check means a demand draft, drawn on or payable through or at an office of a bank, whether negotiable or not, that is handled for forward collection or return, including a substitute check. Check does not include a noncash item or an item payable in a medium other than United States money.

(f) Consumer means an individual who-

- (1) With respect to a check handled for forward collection, draws a check on an account used primarily for personal, family, or household purposes; or
- (2) With respect to a check handled for return, deposits the check into an account used primarily for personal, family, or household purposes.

(g) Indemnifying bank means a bank that provides an indemnity under section 5 of this Act.

(h) MICR (magnetic ink character recognition) line means the numbers, which may include the bank routing number, account number, check number, check amount, and other information printed near the bottom of a check in magnetic ink in accordance with generally applicable industry standards.

(i) Noncash item has the meaning given to such term in section 229.2 of title 12, Code

of Federal Regulations.

(j) Person means a natural person, corporation, unincorporated company, partnership, government unit or instrumentality, trust, or any other entity or organization.

(k) Reconverting bank means the bank that creates a substitute check. If a substitute check is created by a party other than a bank, then the reconverting bank is the first bank that transfers or presents that substitute check.

(l) Returning bank has the meaning given to such term in section 229.2 of title 12, Code of Federal Regulations.

(m) Substitute check means a paper reproduction of the original check that-

(1) Contains an image of the front and back of the original check that bears a MICR line containing all the information encoded on the original check at the time the original check was issued, as well as the amount; and

(2) Conforms, in paper stock, dimension, and otherwise, with generally applicable industry standards for substitute checks.

(n) State means a State of the United States, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, or a territory, possession, or dependency of the United States.

(o) Uniform Commercial Code or U.C.C. means the Uniform Commercial Code in effect in a state.

(p) Unless the context requires otherwise, the terms not defined in this section have the meanings set forth in the U.C.C.

SECTION 3. SUBSTITUTE CHECKS.

(a) No agreement required. A person may deposit, present, or send for collection or return a substitute check without an agreement with the recipient, so long as a bank has made the substitute check warranties in section 4 to the recipient with respect to that check.

(b) Legal equivalence. A substitute check is the legal equivalent of the original check for all purposes, including federal and state law, and for all persons if it-

(1) Accurately and legibly represents all of the information on the front and back of the original check as of the time the original check was issued; and

(2) Bears the legend: "This is a legal copy of your check. You can use it the same way you would use the original check."

(c) Indorsements. A reconverting bank shall ensure that the substitute check that it creates bears the indorsements of all previous parties that applied an indorsement to the check, whether they indorsed on paper or in electronic form.

(d) Identification of reconverting bank. A reconverting bank shall identify itself as a reconverting bank on the substitute check in conformance with generally applicable industry standards.

(e) Applicable law. A substitute check that is the legal equivalent of the original check under paragraph (b) of this section shall be subject to all other applicable federal or state law

as if it were the original check, to the extent such law is not inconsistent with this Act.

SECTION 4. SUBSTITUTE CHECK WARRANTIES.

A bank that transfers or presents a substitute check and receives consideration for it warrants to the transferee, any subsequent collecting or returning bank, the depositary bank, the drawee, the drawer, the payee, the depositor, and any indorser (regardless of whether the party receives the substitute check or another paper or electronic form of the check) that-

(a) The substitute check meets all the requirements for legal equivalence under section 3(b); and

(b) No depositary bank, drawee, drawer, or indorser will receive presentment or return of the substitute check, the original check, or a copy or other paper or electronic version of the substitute check or original check such that it will be asked to make a payment based on a check it has already paid.

SECTION 5. INDEMNITY.

(a) Indemnity. A reconverting bank that creates a substitute check and each bank that subsequently transfers or presents that check in any electronic or paper form and receives consideration for the check shall indemnify the transferee, any subsequent collecting or returning bank, the depositary bank, the drawee, the drawer, the payee, the depositor, and any indorser, up to the amount described in paragraphs (b) and (c), to the extent of any loss incurred by a recipient of a substitute check, if that loss is due to the receipt of a substitute check instead of the original check.

(b) Indemnity amount. The amount of the indemnity under paragraph (a) shall be the amount of any loss proximately caused by a breach of a warranty provided under section 4 if that loss would not have occurred had the original check been transferred or presented. In the absence of a breach of a warranty provided under section 4, the amount of the indemnity shall be the amount of any loss, up to the amount of the check plus interest and expenses, if that loss would not have occurred had the original check been transferred or presented.

(c) Comparative negligence. If a loss described in paragraph (a) results in whole or in part from the negligence or failure to act in good faith on the part of an indemnified party, then that party's indemnification under this section shall be reduced in proportion to the amount of negligence or bad faith attributable to that party.

(d) Effect of producing original check. If the indemnifying bank produces the original check, it is liable only for losses covered by the indemnity that are incurred up to that time, and it has a right to a return of any funds it has paid under the indemnity in excess of those losses. Production of the original check does not absolve the indemnifying bank from any liability on a warranty that it has given under this Act or other law.

(e) Subrogation of rights. A bank that indemnifies a party under this section may attempt to recover from another party based on a warranty or other claim. Each indemnifying

bank is subrogated to the rights of any indemnified party to the extent of the indemnity. Each indemnified party has a duty to comply with all reasonable requests for assistance from the indemnifying bank in connection with any warranty claim the indemnifying bank brings against a warrantor.

SECTION 6. EXPEDITED RECREDIT PROCEDURES FOR CONSUMERS.

(a) When a consumer may make a claim. (1) Except as provided in paragraph (d), a consumer may make a claim for expedited recredit from the bank that holds the consumer's account if the consumer asserts in good faith that-

(i) The bank charged the consumer's account for a substitute check that was provided to the consumer and that was not properly charged to that account or for which the consumer has a warranty claim;

(ii) The consumer suffered a resulting loss; and

(iii) The original check is necessary to determine the validity of the charge to the consumer's account or the warranty claim.

(2) The consumer must submit the claim to the bank within 60 days after the relevant statement or check is made available to the consumer. If the consumer's ability to submit the claim within the 60-day time period is delayed due to extenuating circumstances, including, but not limited to, extended travel or hospitalization, the 60-day period shall be extended by a reasonable amount of time.

(b) How to make a claim. (1) To make a claim under paragraph (a) of this section, the consumer must provide to the bank-

(i) A description of the claim, including an explanation of why the check was not properly charged to the account or of the warranty claim;

(ii) A statement that the consumer suffered a loss and an estimate of the amount of the loss;

(iii) The reason why the original check must be produced in order to determine the validity of the charge to the consumer's account or the warranty claim; and

(iv) Sufficient information to identify the check and to investigate the claim.

(2) The bank may require the consumer's claim to be in writing.

(c) Recredit to consumer. If the consumer makes a claim in accordance with paragraphs (a) and (b) of this section against the bank that charged the consumer's account, then that bank must either produce the original check and show that the check was properly charged from the account or recredit the consumer's account for the amount of the claim, up to the amount of the check or \$2,500, whichever is less, no later than the business day following the banking day the consumer makes the claim, unless an exception described in paragraph (d) applies. The bank must credit the consumer's account for the remainder of the amount of the

claim, up to the amount of the check, plus interest, on the business day following the banking day on which the bank determines that the consumer's claim is valid, but no later than 20 business days following the banking day the consumer makes the claim. Providing a recredit does not absolve the bank from liability for wrongful dishonor under the U.C.C. or other law or from liability for additional damages under section 5 or 8 of this Act. The bank may reverse the recredit to the consumer's account when it provides the original check to its consumer, if the check was properly charged to the account.

(d) Availability of recredit. A bank must make recredited funds available for withdrawal by the start of the next business day after the recredit is required to be applied to the account. If a recredit is required by the business day following the banking day the consumer makes a claim, the bank may delay availability of that recredit until the twentieth business day following the banking day on which the consumer makes such claim if-

(1) The claim is made during the 30-day period beginning on the banking day the consumer's account was established;

(2) Without regard to the charge that is the subject of the claim, on six or more banking days within the preceding six months the consumer's account balance was negative or would have become negative if checks or other charges to the account had been paid, or on two or more banking days within the preceding six months the consumer's account balance was negative or would have become negative in the amount of \$5,000 or more if checks or other charges to the account had been paid;

(3) The bank has reasonable cause to believe that the claim is fraudulent, based on facts (other than the fact that the check in question or the consumer is of a particular class) that would cause a well-grounded belief in the mind of a reasonable person that the claim is fraudulent; or

(4) There has been an interruption of communications, computer, or equipment facilities, or other emergency condition beyond the control of the bank, provided the bank exercises such diligence as the circumstances require.

SECTION 7. EXPEDITED RECREDIT PROCEDURES FOR BANKS.

(a) When a bank may make a claim. (1) A bank may make a claim against a previous indemnifying bank and receive expedited recredit if-

(i) (A) A consumer claims that a substitute check cannot be properly charged to the consumer's account at that bank or otherwise asserts an indemnity or warranty claim related to a substitute check; or

(B) The claimant bank wishes to assert an indemnity or warranty claim related to a substitute check;

(ii) The claimant bank has suffered a resulting loss or is obligated to recredit a consumer's account under section 6; and

(iii) The original check is necessary to determine the validity of the

charge to the consumer's account or the warranty claim.

(2) The bank must submit a claim relating to a substitute check to the indemnifying bank within 120 days after the day of the transaction that gave rise to the claim.

(b) How to make a claim. To make a claim under paragraph (a) of this section, the bank must provide to the indemnifying bank-

(1) A description of the claim, including an explanation of why the check cannot be properly charged to the consumer's account or of the warranty claim;

(2) A statement that it has suffered a loss or is obligated to recredit a consumer's account under section 6 due to the charge or warranty claim and an estimate of the amount of the loss;

(3) The reason why the original check must be produced in order to determine the validity of the charge to the consumer's account or the warranty claim; and

(4) Sufficient information for the indemnifying bank to identify the check and to investigate the claim. This information may include, for example, a copy of the check or checks at issue. Any copies must be clearly labeled as copies so that they cannot be mistaken for the legal equivalent of the check. These copies must not be sent or handled as returned checks. At the request of the indemnifying bank, the claimant bank must provide a copy of the consumer's claim, if any exists.

(c) Recredit by indemnifying bank. No later than 10 business days after receiving the claim, the indemnifying bank must either produce the original check or recredit the indemnified bank for the amount of the claim, up to the amount of the check, plus interest. Providing a recredit does not absolve the indemnifying bank from liability for additional damages under section 5 or 8 of this Act. If the indemnifying bank produces the original check, its right to a return of any funds it has paid is governed by section 5(d).

SECTION 8. MEASURE OF DAMAGES.

(a) Measure of damages. Except as provided in section 5, damages for breach of warranty or failure to meet any requirement of this Act shall be an amount equal to the loss suffered as a result of the breach or failure, but not more than the amount of the check or checks in question, plus interest and expenses, including costs and attorney's fees related to the check. Damages, if any, are reduced by the amount, if any, that the claimant receives and retains as a recredit.

(b) Comparative negligence. If a party incurs damages that resulted in whole or in part from that party's negligence or failure to act in good faith, then the damages due to that party under paragraph (a) shall be reduced in proportion to the amount of negligence or bad faith attributable to that party.

SECTION 9. STATUTE OF LIMITATIONS AND NOTICE OF CLAIM.

(a) Statute of limitations. An action to enforce a claim under this Act may be brought in any United States district court, or in any other court of competent jurisdiction, and shall be brought within three years after the cause of action accrues.

(b) Notice of claim. Unless a claimant gives notice of a claim to the indemnifying or warranting bank within 30 days after the claimant has reason to know of the claim and the identity of the indemnifying or warranting bank, the indemnifying or warranting bank is discharged to the extent of any loss caused by the delay in giving notice of the claim.

SECTION 10. EFFECT ON OTHER LAW.

This Act shall supersede any provision of Federal or State law, including the Uniform Commercial Code, that is inconsistent with this Act.

SECTION 11. REGULATIONS.

The Board of Governors of the Federal Reserve System may prescribe such regulations it determines to be appropriate to carry out the provisions of this Act.

SECTION 12. EFFECTIVE DATE.

This Act is effective one year after the date of enactment.
